

## Message Text

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ACTION SS-25

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FM AMEMBASSY MEXICO

TO SECSTATE WASHDC IMMEDIATE 6378

C O N F I D E N T I A L SECTION 1 OF 2 MEXICO 9534

EXDIS

FOR UNDERSECRETARY ROGERS, GREENWALD (EB), AND POATS (E)

DEPT PASS TREASURY FOR BRUCE BENTON

EO 11652: GDS

TAGS: UNGA EFIN

SUBJECT: QUESTIONS AND ANSWERS ON THE INTERNATIONAL RESOURCE BANK

BEGIN SUMMARY:

IN SESSION SUNDAY AFTERNOON ATTENDED BY HARREL (EB), ROSEN (L) AND MYSELF FROM STATE AND BENTON AND BELFORD FROM TREASURY, WE REACHED AGREEMENT ON A SET OF QUESTIONS AND ANSWERS CONCERNING THE IRB EXCEPT FOR SOME BRACKETS IN QUESTIONS 6, 9, 34, 35, 36, 42. THERE ARE REALLY, HOWEVER, JUST TWO ISSUES WHICH NEED TO RESOLVED:  
--WHETHER THE IRB WILL BE ABLE TO ISSUE BONDS ON BEHALF OF THE PROJECT AND TURN OVER THE PROCEEDS FROM THE SALE OF SUCH BONDS IN THE FORM OF A LOAN TO A PROJECT IN A STRAIGHT BACK-TO-BACK OR PASS-THROUGH OPERATION (SEE BRACKETS IN QUESTIONS 5, 9, 34, 35 AND 36), AND  
-- WHETHER WE WILL REMAIN OPEN TO CONSIDERING A ROLE FOR THE IRB IN RELATION TO SUPPLEMENTAL BUFFER STOCK FINANCING (SEE BRACKET IN QUESTION 42). END SUMMARY.

1. THESE ISSUES WILL BE DISCUSSED AT CPCC MEETING THIS WEEK AND AT EPB MEETING WHICH MIGHT FOLLOW WEEK AFTER.

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2. BACKGROUND TO FIRST ISSUE:

IN THE ORIGINAL PROPOSAL FOR THE IRB, IT WAS ENVISIONED THAT THE IRB COULD PERFORM ITS GUARANTEE FUNCTION IN TWO DIFFERENT WAYS. FIRST, THE IRB COULD GUARANTEE AGAINST SPECIFIC COMMERCIAL RISKS PROJECT BONDS ISSUED BY THE PROJECT ENTITY. SECOND, THE IRB COULD ISSUE BONDS, THE PROCEEDS OF WHICH WOULD BE TURNED OVER DIRECTLY TO THE PROJECT ENTITY.

3. BOTH THESE MODES OF OPERATION WOULD DIFFER SUBSTANTIALLY FROM PRACTICE OF INVESTMENT INSURANCE AGENCIES SUCH AS OPIC AND OF THE WORLD BANK (SPECIFICALLY THE IBRD). UNLIKE OPIC, THE NON-COMMERCIAL GUARANTEES WOULD BE SPECIFIED IN A TRILATERAL CONTRACT AND THE GUARANTEES WOULD APPLY TO A WIDE RANGE OF PRODUCTION FINANCE, INCLUDING THAT ASSOCIATED WITH PRODUCTION-SHARING, RATHER THAN FOCUS PRIMARILY ON INSURANCE OF EQUITY AGAINST POLITICAL RISK. UNLIKE THE WORLD BANK, THE BONDS ISSUED BY THE IRB WOULD BE CLEARLY ASSOCIATED WITH THE PROJECT AND REPRESENT A CLAIM ON THE CASH FLOW OF THAT PROJECT, POSSIBLY A CLAIM ON THE PHYSICAL PRODUCT OR THE PROCEEDS OF THE SALE OF THAT PRODUCT, AND POSSIBLY A CLAIM ON THE HOST GOVERNMENT WHICH MIGHT BE REQUIRED TO PROVIDE AN ALL-RISK GUARANTEE OF IRB ISSUED PROJECT BONDS. ALSO, UNLIKE THE WORLD BANK, HOLDERS OF THE BONDS, EITHER THOSE ISSUED BY THE IRB OR BY THE PROJECT ENTITY, WOULD HAVE ONLY LIMITED RECOURSE TO THE PAID-IN AND CALLABLE CAPITAL CONTRIBUTIONS OF THE IRB. THIS RECOURSE WOULD BE LIMITED TO NON-COMMERCIAL RISKS. IN CONTRAST, HOLDERS OF WORLD BANK OR REGIONAL DEVELOPMENT BONDS HAVE FULL RECOURSE TO PAID-IN AND CALLABLE CAPITAL IN THE EVENT OF GOVERNMENTAL DEFAULTS.

4. BOTH MODES OF OPERATION OF THE IRB, AS ISSUES AND AS GUARANTOR, WERE REFERRED TO IN US STATEMENT ON THE IRB SUBMITTED AT CIEC.

BACKGROUND TO SECOND ISSUE:

5. IN THE ORIGINAL PROPOSAL, THE IRB HAD TWO FUNCTIONS:  
1) FACILITATING INVESTMENT IN RESOURCE PROJECTS, AND 2) A ROLE IN PROVIDING SUPPLEMENTAL FINANCE FOR BUFFER STOCKS. BUFFER STOCK FUNCTION WAS GREATLY REDUCED IN THE PROCESS OF DISCUSSION  
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WITHIN THE US GOVERNMENT, BUT A DECISION WAS MADE AT CABINET LEVEL THAT THE US GOVERNMENT WAS WILLING TO CONSIDER A ROLE FOR THE IRB IN RELATION TO SUPPLEMENTAL BUFFER STOCK FINANCE. HIGHLY NEGOTIATED LANGUAGE TO THIS EFFECT WAS INCLUDED IN SECRETARY KISSINGER'S MAY 6 SPEECH AT UNCTAD.

6. IT WAS HOPED THAT AN IRB ROLE IN BUFFER STOCK FINANCE

MIGHT BE SEEN AS A POSSIBLE WAY TO APPROACH THE BUFFER STOCK FINANCING ISSUE IN A MORE CONSTRUCTIVE AND USEFUL MANNER THAN WAS THE CASE WITH THE G-77 PROPOSALS FOR A COMMON FUND. WE ACHIEVED LITTLE SUCCESS IN THIS REGARD AT NAIROBI. SINCE UNCTAD, HOWEVER, A NUMBER OF LDC GOVERNMENT OFFICIALS HAVE EXPRESSED INFORMALLY AN INTEREST IN A ROLE FOR THE IRB IN RELATION TO BUFFER STOCK FINANCING. THE GOVERNMENT OF BRAZIL HAS OFFICIALLY ASKED FOR A CLARIFICATION OF THIS ISSUE SINCE BRAZIL MIGHT FIND THE IRB MORE ATTRACTIVE IF SUCH A ROLE WERE INCLUDED AS AN IRB FUNCTION.

DISCUSSION OF FIRST ISSUE:

7. THERE ARE A NUMBER OF ADVANTAGES TO HAVING THE IRB ISSUE PROJECT BONDS ON BEHALF OF A PROJECT:

- THE IRB, BY EXECUTING A SEPARATE LOAN AGREEMENT WITH THE PROJECT, COULD MORE LEGITIMATELY DECLARE THE LOST COUNTRY GOVERNMENT IN DEFAULT.
- DEFAULT TO AN INTERNATIONAL ORGANIZATION LIKE THE IRB WOULD BE A FAR MORE SERIOUS STEP FOR A HOST COUNTRY GOVERNMENT THAN DEFAULT AGAINST A PRIVATE INVESTOR.
- CROSS DEFAULT PROCEDURES IN WHICH THE HOST COUNTRY WOULD ALSO BE IN DEFAULT TO THE WORLD BANK OR REGIONAL DEVELOPMENT BANKS WOULD BE MORE LEGITIMATE.
- THE USE OF THE IRB TO ISSUE BONDS WOULD DISTINGUISH THE IRB PROPOSAL MORE MEANINGFULLY FROM A STRAIGHT MULTILATERAL INSURANCE INSTITUTION.
- THE IRB-ISSUED BONDS MIGHT BE MORE MARKETABLE SINCE THEY WOULD PROBABLY BE REGARDED AS LESS RISKY BY PRIVATE INVESTORS.
- THE IRB ROLE IN ISSUING BONDS AND LENDING THE PROCEEDS TO A PROJECT ENTRY WOULD PRECLUDE THE NEED FOR AN ACTIVE IBRD ROLE IN LENDING DIRECTLY TO NUMEROUS PROJECTS RATHER THAN ONLY FOR INFRASTRUCTURE RELATED TO NUMEROUS PROJECTS.

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THE US POSITION IS THAT THE IBRD IS MORE SUITED FOR LENDING TO INFRASTRUCTURE INVESTMENTS THAN DIRECTLY TO MINERAL PROJECTS.

NOTE BY OC/T: NOT PASSED TREASURY.

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ACTION SS-25

INFO OCT-01 ISO-00 SSO-00 /026 W

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O 262100Z JUL 76

FM AMEMBASSY MEXICO

TO SECSTATE WASHDC IMMEDIATE 6379

C O N F I D E N T I A L SECTION 2 OF 2 MEXICO 9534

EXDIS

FOR UNDERSECRETARY ROGERS, GREENWALS(EB), AND POATS(E) FROM FRANK

DEPT PASS TREASURY FOR BRUCE BENTON

8. THE MAJOR DISADVANTAGE OF ALLOWING THE IRB TO ISSUE BONDS IS THAT THE IRB CAPITAL WOULD BE ENCUMBERED IN A WAY THAT MIGHT REDUCE THE ATTRACTIVENESS OF STRAIGHT IRB GUARANTEES. ALSO IF THE IRB HAD THIS FUNCTION, THE PROPOSAL WOULD BE LESS DISTINGUISHABLE FROM THE FUNCTIONS NOW PERFORMED BY THE WORLD BANK.

9. I WOULD SUGGEST THAT THE CPCC AND THE EPB CONSIDER TWO OPTIONS WITH RESPECT TO THE Q'S AND A'S. THESE Q'S AND A'S ARE EXPECTED TO BE DISTRIBUTED TO CAPITALS.

OPTION 1--KEEP THE BRACKETED LANGUAGE IN THE Q'S AND A'S, IMPLYING A ROLE FOR THE IRB AS AN ISSUER OF BONDS.

PROS:

--IMPLIES A MORE MEANINGFUL AND FLEXIBLE IRB INSTITUTION.  
--AFFORDS GREATER PROTECTION FOR INVESTORS AND INHIBITS HOST COUNTRY INCLINATIONS TO DEFAULT OR TO EXPROPRIATE.

CONS:

--COMPLICATES THE IRB PROPOSAL AND ADDS TO THE CLAIMS ON THE IRB CAPITAL STRUCTURE.  
--DISTINGUISHES THE IRB LESS CLEARLY FROM EXISTING WORLD BANK FUNCTIONS.

OPTION 2--DELETE BRACKETED LANGUAGE BUT KEEP OPEN THE POSSIBILITY OF AN IRB FUNCTION AS ISSUER OF BONDS.

PROS:

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--WOULD ALLOW FOR A MORE CAREFUL ANALYSIS OF THE ADVANTAGES AND DISADVANTAGES OF THIS FUNCTION FOR THE IRB BEFORE THE USG BECOMES COMMITTED.  
--DISTINGUISHES THE IRB MORE FROM WORLD BANK FUNCTIONS.

CONS:

--DETRACTS FROM THE INSTITUTIONAL CAPABILITIES OF THE IRB.

--DISTINGUISHES THE IRB LESS FROM A MULTILATERAL  
INVESTMENT INSURANCE SCHEME.

DISCUSSION OF THE SECOND ISSUE:

10. I WOULD ALSO SUGGEST THAT THE CPCC AND TPJ EPB  
CONSIDER TWO OPTIONS ON THE Q'S AND A'S WITH REGARD  
TO AN IRB ROLE IN RELATION TO SUPPLEMENTAL FINANCE OF  
BUFFER STOCKS.

OPTION 1. KEEP THE BRACKETED LANGUAGE IN QUESTION  
42 TO INDICATE THAT THE U.S. WILL CONSIDER A ROLE  
FOR THE IRB IN RELATION TO SUPPLEMENTAL FINANCE OF  
BUFFER STOCKS.

PROS:

--WOULD INDICATE THAT THE U.S. MADE THE ORIGINAL  
PROPOSAL IN GOOD FAITH AND STILL BELIEVES AN  
IRB ROLE IN THIS REGARD IS PREFERABLE TO A COMMON FUND.

--KEEPS OPEN THE POSSIBILITY OF AN ALTERNATIVE TO  
THE COMMON FUND WHICH SOME LDC'S MIGHT FIND MORE  
ATTRACTIVE THAN THE COMMON FUND.

CONS:

--MAY MAKE THE IRB SEEM TO BE AN ALTERNATIVE  
TO THE COMMON FUND AND TO UNDERMINE SUPPORT FOR  
THE COMMON FUND.

--IT IS NOT CLEAR HOW THE IRB CAN PLAY A USEFUL  
ROLE IN REGARD TO SUPPLEMENTAL FINANCE OF BUFFER  
STOCKS, E.G. WOULD THE IRB GUARANTEE NON-COMM-  
ERCIAL RISK IN BUFFER STOCK OPERATION AND WHAT  
WOULD BE THESE COMMERCIAL RISKS.

OPTION 2. INSERT, INSTEAD OF THE BRACKETED SENTENCE  
OF THE ANSWER TO QUESTION 42, THE FOLLOWING SENTENCE:  
BEGIN QUOTE. ALTHOUGH SECRETARY KISSINGER HAS SAID THAT  
THE U.S. WOULD CONSIDER SUCH A ROLE, WE DO NOT SEE THE  
IRB AS A COMPETITOR OR ALTERNATIVE TO THE COMMON FUND  
WHICH HAS BEEN PROPOSED AS A MEANS TO FINANCE  
BUFFER STOCKS. END QUOTE. (ALSO STRIKE THE WORD  
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HOWEVER FROM THE NEXT SENTENCE).

PROS:

--MAKES IT CLEAR WHY WE DO NOT EXPECT A ROLE FOR  
THE IRB IN SUPPLEMENTAL FINANCE FOR BUFFER STOCKS.

CON:

--IS A STEP BACKWARD FROM A POSITION STATED IN  
THE KISSINGER SPEECH THAT WAS MORE FORTHCOMING  
AND OPEN.

NEXT STEPS:

FOR THE CPCC AND EPB MEETINGS, STATE OUGHT TO  
PREPARE A MEMO ALONG THE LINES OF THIS CABLE WHICH LAYS

OUT THE ISSUES AND THE PROS AND CONS OF VARIOUS OPTIONS.  
THERE ARE FUNDAMENTAL POLICY QUESTIONS THAT DESERVE  
CAREFUL SCRUTINY.

11. I PERSONALLY FEEL THAT IT WOULD BE A GREAT MISTAKE  
TO DELETE THE BRACKETED LANGUAGE. I BELIEVE THAT WHETHER  
THE IRB ISSUES BONDS OR NOT IS VERY IMPORTANT TO ITS  
SUCCESS AS AN INSTITUTION AND ITS EFFECTIVENESS IN  
MODERATING LDC INVESTMENT BEHAVIOR. THE BRACKETED LANGUAGE  
IS SO HEDGED WITH MIGHTS AND COULDS, IT DOES NOT COMMIT  
THE U.S. TO SUCH A ROLE FOR THE IRB.

12. IF THE U.S. STEPS BACK FROM THE KISSINGER SPEECH,  
WHEN ASKED SPECIFICALLY (AS WE HAVE BY BRAZIL)  
WHETHER WE MEANT WHAT WE SAID OR NOT RUNS THE VERY SERIOUS  
RISK OF BEING BADLY MISINTERPRETED IN LDC CAPITALS. THE  
BRACKETED LANGUAGE IN QUESTION 42 IS SO THOROUGHLY  
HEDGED BY THE SENTENCE AFTER IT, I DON'T THINK WE RUN  
ANY GREAT RISK IN STANDING PAT.

FOR BRUCE BENTON:

13. I CAUGHT A COUPLE MINOR PROBLEMS IN THE Q'S AND  
A'S THAT WE OVERLOOKED IN OUR SUNDAY MEETING. YOU MIGHT  
CORRECT THEM FOR THE VERSION OF THE Q'S AND A'S THAT  
GOES TO THE CPCC AND THE EPB.

14. QUESTION 10, THIRD SENTENCE OF THIRD PARAGRAPH  
SHOULD READ: THE ADVANTAGES TO HAVING INSTRUMENTS  
OF THIS SORT AS ELEMENTS IN THIS TRANSACTION ARE TWOFOLD.  
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15. QUESTION 12. THE THREE REFERENCES IN THAT QUESTION  
AND ANSWER TO IRB OR PROJECT BONDS SHOULD BE REFERENCES  
TO IRB GUARANTEED PROJECT BONDS (TO BE CONSISTENT WITH  
OTHER QUESTIONS).  
JOVA

NOTE BY OC/T: NOT PASSED TREASURY.

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